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MERCURY · CHIPMAN COMPANY LIMITED

Head Office: Room 1404 - 302 Bay Street - Toronto 1, Canada

Mercury-Chipman Company Limited

Directors' Report

Toronto,

August 3rd, 1962.

TO THE SHAREHOLDERS:

Your Directors take pleasure in submitting herewith their report on your Company's operations together with audited financial statements covering the period ended April 30th, 1962.

Oil Production

Your Company is participating equally with Robt. McMaster & Sons Co. Ltd. in the development of approximately 5,000 acres of oil and gas leases in the Princeton-Gobles field, about ten miles east of Woodstock, Ontario. The Princeton-Gobles field is a new area for oil and natural gas, the discovery well having been brought in about two years ago. A leasing rush developed immediately after the discovery, and most of the land in the area is now under lease. Imperial Oil and Paris Petroleums are among the major companies active in the field.

Ontario is the largest market in Canada for both crude oil and petroleum products, and there is no prorationing or restriction of production. This field is ideally located, lying about half-way between the major refineries at Sarnia and Petrolia in the west and Clarkson in the Toronto-Hamilton area.

Thirteen wells have been drilled to date by the Mercury-McMaster partnership into the oil and gas bearing zone, which lies at about 2,900 feet. Eleven wells have been successfully completed and are on production. One well was completed but abandoned as non-commercial and the last well—on an offset location, adjoining a producing well—has been drilled to the indicated depth and is now being completed for production. Indications are that this well will also be a successful producer.

Daily production is running at approximately 260 barrels of thirty-nine degree gravity oil, which is trucked to Sarnia at a cost of 50¢ per barrel and sold under contract to Imperial Oil at a present price of $3.22 per barrel. No restraint on full development of the Mercury-McMaster holdings has yet been established, except the possibility that an occasional location—as in the case of the one well abandoned as non-commercial—will find the productive zone too cemented to yield commercial quantities of oil and/or gas. Your Directors believe that prospects are very bright for a continued successful development program in this field.

In addition to the foregoing, your Company holds outright, subject to usual landowners' royalties, some 2,100 acres under lease lying to the northwest of the leases we hold in partnership with McMaster. A well has just been drilled as a successful producer less than one-half mile north of this acreage. As a result of this well having been brought in and the close proximity of our leases thereto, chances for the discovery of oil on our lands are greatly enhanced. Considerable interest has been evinced in these holdings and your Directors are presently reviewing plans for their development.

Miscellaneous

You had previously been advised of an experimentation in the field of polyurethane lamination and fabrication. Considerable research was done on this project and a machine constructed for test purposes. Unfortunately from an economic and production standpoint the process was not feasible and accordingly has not been proceeded with.

Enclosed with this Report is a Notice calling the Annual and a Special General Meeting of the Shareholders. Some years ago when your Company manufactured textiles, very heavy losses were sustained which resulted in a substantial deficit as reflected in the enclosed financial statements. With the changes in our financial position resulting from the successful development of our oil leases, your Directors felt that our financial statements should be reviewed in view of our present cash flow from oil sales.

By-law No. 5-A, a copy of which is enclosed, is a By-law designed to bring our balance sheet up to date and substantially reduce the deficit through a reduction in the amount attributable to paid up capital. This will in no way affect your shares or your interest in the Company. At the same time it was felt that additional unissued treasury shares should be available to your Company if required in the future and By-law No. 5-A also makes provision in this regard.

The basic By-laws relating to your Company were enacted some forty years ago and our solicitors have advised that they should be amended in a number of respects. With this thought in mind your Directors have enacted a new general By-law and By-laws relating to borrowing, Registrars and Transfer Agents and Banking. It was felt that these By-laws should be forwarded to the Shareholders for consideration before their approval and, at the same time, we decided to print them in a booklet which could be saved by you so that you will have a permanent record available to you of our main By-laws.

It is hoped that as many Shareholders as possible will endeavour to attend the forthcoming Meeting. If you are unable to be personally present you are requested to sign and return the enclosed proxy in the envelope provided for that purpose.

Respectfully submitted

On behalf of the Board,

V. F. BOWMAN,
President.

FISHER, SANDERS, STERN AND NISKER
CHARTERED ACCOUNTANTS
TORONTO - NORTH BAY - WINDSOR

Auditors' Report

To the Shareholders of

MERCURY-CHIPMAN COMPANY LIMITED:

We have examined the following statements of Mercury-Chipman Company Limited:

(1) Balance sheets as at December 31, 1961 and April 30, 1962;

(2) Interim statement of profit and loss for the four months ended April 30, 1962;

(3) Statement of deficit for the period from June 1, 1960 to December 31, 1961 and for the four months ended April 30, 1962;

(4) Deferred general oil exploration and administrative expenditures for the period from June 20, 1960 to December 31, 1961;

(5) Deferred exploration on mining claims for the period from October 7, 1961 to December 31, 1961 and for the four months ended April 30, 1962.

Our examination covered the period from June 20, 1960 to April 30, 1962 and included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances. We have obtained all the information and explanations we have required.

In our opinion, and according to the best of our information and the explanations given to us and as shown by the books of the company, the financial statements set forth above are properly drawn up so as to exhibit a true and correct view of the financial affairs of the company as at December 31, 1961 and as at April 30, 1962 and the results of its operations for the four months ended April 30, 1962, and its activities for the period from June 20, 1960 to December 31, 1961, in accordance with generally accepted accounting principles.

FISHER, SANDERS, STERN AND NISKER,
Chartered Accountants.

Toronto, Ontario,
June 1, 1962.

Mercury-Chipma

(Incorporated under the law

Bala

AS AT DECEMBER 31,

(With comparative figures as at December 31, 1960)
(Note 1)

	December 31, 1960 (Fiscal Year End)	December 31, 1961 (Fiscal Year End)	April 30, 1962 (Interim)
Assets			
CURRENT ASSETS			
Cash	$ 8,514.50	$ 55,536.88	$ 20,822.05
Accounts receivable	18,254.59	—	8,310.16
Advance re geophysical survey	—	2,500.00	—
	$ 26,769.09	$ 58,036.88	$ 29,132.21
INVESTMENTS			
$1,000.00 Quebec Hydro bond on deposit with Quebec Securities Commission, at cost	$ —	$ 830.00	$ 830.00
Marketable securities, at cost (market value $12,250.00)	—	—	11,900.00
Investment in subsidiary company (Note 3)	—	—	1.00
	$ —	$ 830.00	$ 12,731.00
CAPITAL ASSETS, at cost			
Interests in petroleum and natural gas leases (Note 4)	$ 6,250.00	$ 6,250.00	$ 6,250.00
Intangible well costs	61,191.33	123,740.44	139,823.32
	$ 67,441.33	$129,990.44	$146,073.32
Less—accumulated allowance for depletion (Note 5)	—	4,040.05	7,210.58
	$ 67,441.33	$125,950.39	$138,862.74
Well equipment, at cost less $4,694.39 accumulated allowance for depreciation at December 31, 1961 and $7,899.64 at April 30, 1962 (Note 5)	17,841.30	34,432.38	39,863.87
Mining claims, at valuation of $30,000.00 attributed to 100,000 shares of capital stock issued for the claims and $15,000.00 paid in cash	—	35,000.00	35,000.00
	$ 85,282.63	$195,382.77	$213,726.61
DEFERRED EXPENDITURES AND OTHER ASSETS			
General oil exploration and administrative expenditures, per statement (Note 6)	$ 33,332.59	$168,199.36	$168,199.36
Less—amounts written off to profit and loss (Note 6)	—	—	2,272.40
	$ 33,332.59	$168,199.36	$165,926.96
Deferred exploration expenditures on mining claims, per statement	—	617.73	8,617.73
A first right of refusal to acquire a 50% interest in Licenses of Occupation in Lake Huron (Note 7)	58,083.92	58,305.86	58,305.86
	$ 91,416.51	$227,122.95	$232,850.55
TOTAL ASSETS	$203,468.23	$481,372.60	$488,440.37

The accompanying notes are an integral part of the financial statements.

Company Limited

the Government of Canada)

Sheet

61 AND APRIL 30, 1962

(With comparative figures as at December 31, 1960)
(Note 7)

	December 31, 1960 (Fiscal Year End)	December 31, 1961 (Fiscal Year End)	April 30, 1962 (Interim)
Liabilities			
CURRENT LIABILITIES			
Accounts payable	$ 46,226.56	$ 41,288.14	$ 52,111.83
Loan payable	10,000.00	—	—
Notes payable:			
Notes due March 10, 1961 (Note 1)	24,619.07	—	—
Notes due March 31, 1961 (Note 7)	19,883.92	—	—
Interest payable and incurred on long-term notes	—	1,940.22	2,137.12
	$ 100,729.55	$ 43,228.36	$ 54,248.95
NON-CURRENT LIABILITIES			
Notes payable, due February 28, 1962	$ 40,000.00	$ —	$ —
Notes payable, due March 10, 1970 (Note 1)	61,405.13	35,333.47	33,335.31
	$ 101,405.13	$ 35,333.47	$ 33,335.31
CAPITAL AND DEFICIT			
CAPITAL STOCK (Notes 8 and 9)			
Authorized: 3,000,000 shares, no par value			
Issued and fully paid (Note 8):	$ 2,465,796.75	$ 2,867,273.97	$ 2,869,272.13
DEFICIT, per statement (Note 2)	2,464,463.20	2,464,463.20	2,468,416.02
	$ 1,333.55	$ 402,810.77	$ 400,856.11
TOTAL LIABILITIES	$ 203,468.23	$ 481,372.60	$ 488,440.37

The accompanying notes are an integral part of the financial statements.
Approved on behalf of the Board of Directors:

V. F. BOWMAN (Director)

J. A. MURPHY (Director)

Mercury-Chipman Company Limited

NOTES TO FINANCIAL STATEMENTS

NOTE 1—By supplementary letters patent dated June 20, 1960, the company changed its name from Mercury-Chipman Knit Limited to Mercury-Chipman Company Limited and changed the nature of its business from the textile business to the production of and exploration for oil and natural gas.

The company was in bankruptcy and receivership from 1955 to 1959. The receivership was formally terminated by an Order in the Supreme Court of Ontario dated July 23, 1959.

The bankruptcy was annulled by the approval on March 24, 1959 by the Supreme Court of Ontario (in Bankruptcy) of a proposal dated March 28, 1958 submitted by the company to its creditors and approved by them. Pursuant to the said proposal, the company issued convertible notes to its creditors, as follows:

(i) To preferred creditors, their heirs, executors, administrators, nominees or assigns, notes in the aggregate amount of $24,619.07 bearing interest at the rate of 3% per annum, maturing on March 10, 1961 (but redeemable by the company upon call) and convertible by the holders thereof into shares of the company at 50¢ per share; and

(ii) To unsecured creditors, their heirs, executors, administrators, nominees or assigns, notes in the aggregate amount of $635,787.13 bearing interest at the rate of 3% per annum maturing on March 10, 1970 (but redeemable by the company upon call) and convertible by the holders thereof into shares of the company at 50¢ per share.

$291.89 of the notes issued to preferred creditors have been paid in cash and the holders of the balance of the notes in the amount of $24,327.18 have converted their notes into 48,654 shares of the Company's capital stock.

Since the date of issue to April 30, 1962 holders of an aggregate amount of $602,451.82 of the notes issued to unsecured creditors have converted their notes into shares of the company, and the company has duly issued 1,204,898 shares on such conversion. These shares were issued and are held as fully paid and non-assessable shares.

NOTE 2—The deficit of $2,464,463.20 is the deficit of the company as of June 20, 1960, the date the company changed its business to the production and exploration of oil and natural gas.

NOTE 3—Early in 1962, the Company acquired a 75% interest in a newly incorporated company, Mercury-Thermtax Limited, for $299.70. In addition, the Company advanced the subsidiary $11,990.86. This subsidiary was formed to enter into the field of polyurenthane production and fabrication using new methods of "fusing" polyurenthane in its various forms to component materials. The development work carried out by Mercury-Thermtax Limited has not resulted in the development of a commercially feasible product, and accordingly, the Company's investment in the subsidiary company has been written down to a nominal value of $1.00.

NOTE 4—The Operating Agreement, and the Agreement with Romaine Management Limited, whereby the company acquires its interests in the Princeton and Rowe leases respectively, contain no representations or warranties as to the validity of the said leases or of the lessors' title to the leased premises. Preliminary title investigations carried out to date have established the prima facie validity of leases covering approximately 6,000 of the total of 7,250 acres, subject to all existing encumbrances (which may include municipal or provincial restrictions, outstanding taxes, mortgages and other charges against the lands), apparently conflicting grants, minor title defects, and any defects of title which would be disclosed by a complete search. At the time of drilling of a well, a full examination of title is carried out, and the lessee's entitlement to proceeds of oil and/or gas produced from the leased premises is verified. Titles have been thus verified to all of the leases on which wells have been drilled.

NOTE 5—Depletion of leasehold costs and intangible well costs have been provided for on the unit of production method based on estimated reserves of oil. Depreciation of well equipment is provided for on the declining balance method at 10% on oil storage tanks and 30% for other equipment.

NOTE 6—During the period from June 20, 1960 to December 31, 1961 the company was in the formative stage of oil operations. Its activities consisted mainly of acquisition and development of its petroleum and natural gas leases. The expenditures incurred during this period have been deferred net of income from production and no profit and loss statement has been prepared for that period. Commencing with the 1962 fiscal year, the company is preparing profit and loss statements and the deferred expenditures are amortized on the basis that current annual production bears to the overall reserves of the company as at December 31, 1961.

NOTE 7—The company had acquired 50% interest in certain Licenses of Occupation in Lake Huron for the following consideration:

Cash	$ 18,200.00
Note, due March 31, 1961 and convertible into shares of the company's capital stock at 25¢ per share	19,883.92
80,000 shares of the company's capital stock valued at	20,000.00
	$ 58,083.92

Drilling operations in Lake Huron are under suspension, by government order, and the licenses of occupation have been surrendered. The company is entitled to a right of first refusal in respect of exploratory rights on an undivided 50% of the lands within the licences surrendered, exercisable in the event that drilling for oil and gas should again be allowed in this part of Lake Huron. This right expires on May 1, 1970, whether or not the resumption of drilling has been allowed by that date. The company has paid and satisfied its obligations under the note above referred to by the allotment and issuance to the holder thereof, of 79,536 fully paid and non-assessable shares of the company.

NOTE 8—The following is a summary of the company's issued capital stock as at April 30, 1962:

498,830	shares as at June 20, 1960	$ 1,789,957.00
	shares issued since June 20, 1960:	
495,830	shares issued for cash	181,457.75
80,000	shares issued for Licenses of Occupation in Lake Huron	20,000.00
1,333,088	shares issued for conversion of Notes (see Notes 1 and 7)	646,662.92
262,500	shares issued for the surrender of certain rights by participants in joint venture (see Note 10)	105,000.00
200,000	shares issued for settlement of cash loans	102,194.46
100,000	shares issued for mining claims	20,000.00
10,000	shares issued for geophysical data	4,000.00
2,980,248	shares	$ 2,869,272.13

The 498,830 shares issued as at June 30, 1960 at a valuation of $1,789,957.00 are the shares issued prior to the bankruptcy and receivership mentioned in Note 1 above.

NOTE 9—Subject to approval of shareholders, the company will make application for supplementary letters patent confirming by-laws providing for:

(a) Decreasing the capital of the company from $2,869,272.13 to the sum of $632,202.54 by the cancellation of the sum of $2,237,069.59 which amount is no longer represented by available assets.

(b) Increasing the authorized capital by the creation of 2,000,000 additional common shares without par value ranking pari passu with the presently authorized 3,000,000 shares.

When the authorized capital has been increased as aforesaid, 66,670 of the unissued treasury shares will be set aside for the conversion of the outstanding 3% ten-year notes referred to in Note 1. In addition, 122,915 unissued treasury shares will be set aside for outstanding purchase warrants which entitle the holders to purchase 122,915 shares at $1.50 per share on or before the 31st day of August, 1962.

NOTE 10—In order to finance the drilling of wells, the company granted certain rights to other companies. These rights were subsequently surrendered under agreements whereby the company issued a total of 262,500 fully paid and non-assessable shares to the companies holding such rights, in consideration for the surrender thereof.

Mercury-Chipman Company Limited

INTERIM STATEMENT OF PROFIT AND LOSS

FOR THE FOUR MONTHS ENDED APRIL 30, 1962

(Note 6)

OPERATING INCOME		
Crude oil sales	$ 46,888.10	
Less—gross royalties	6,687.46	$ 40,200.64
COST OF OPERATIONS		
Operating expenses	$ 10,313.22	
Depletion of leasehold costs and intangible well costs	3,170.53	
Depreciation of well equipment	3,205.25	16,689.00
GROSS OPERATING PROFIT		$ 23,511.64
ADMINISTRATIVE AND GENERAL EXPENSES		
Manager's salary	$ 1,350.00	
Head office services, including accounting and secretarial fees	1,254.56	
Share certificate cost	495.04	
Audit fees	400.00	
Interest expense	196.90	
Advertising and public relations, and shareholders' information	353.02	
Stock exchange fee and expense	160.10	
Directors' fees	100.00	
Miscellaneous	155.35	4,464.97
NET PROFIT BEFORE DEDUCTING THE UNDERNOTED		$ 19,046.67
OTHER EXPENSES		
Drilling costs of non-commercial well	$ 6,516.88	
Lease rentals on non-producing properties	1,920.65	
Deferred general oil exploration and administrative expenditures (preproduction expenditures) written off	2,272.40	10,709.93
NET PROFIT FOR THE PERIOD		$ 8,336.74

NOTE—No income taxes are payable by the company on its operations to date as a result of the deductibility for income tax purposes of the drilling and exploration costs capitalized in the accounts.

The accompanying notes are an integral part of the financial statements.

STATEMENT OF DEFICIT

FROM JUNE 20, 1960 TO DECEMBER 31, 1961 AND

FOR THE FOUR MONTHS ENDED APRIL 30, 1962

	June 20, 1960 to December 31, 1961	Four Months Ended April 30, 1962
BALANCE AT BEGINNING OF PERIOD (Note 2)	$ 2,464,463.20	$ 2,464,463.20
Add—Amount written off investment in subsidiary company to reduce to nominal value	—	12,289.56
	$ 2,464,463.20	$ 2,476,752.76
Less—Net Profit for Period	—	8,336.74
BALANCE AT END OF PERIOD	$ 2,464,463.20	$ 2,468,416.02

The accompanying notes are an integral part of the financial statements.

Mercury-Chipman Company Limited

DEFERRED EXPLORATION EXPENDITURES ON MINING CLAIMS

FROM OCTOBER 7, 1961 TO DECEMBER 31, 1961 AND

FOR THE FOUR MONTHS ENDED APRIL 30, 1962

	October 7, 1961 to December 31, 1961	Four Months Ended April 30, 1962	October 7, 1961 to April 30, 1962
Engineer's report	$ 500.00	$ —	$ 500.00
Geophysical surveys	—	8,000.00	8,000.00
Miscellaneous	117.73	—	117.73
	$ 617.73	$8,000.00	$8,617.73

NOTE—October 7, 1961 is the date the company acquired the mining claims.

Mercury-Chipman Company Limited

DEFERRED GENERAL OIL EXPLORATION AND ADMINISTRATIVE EXPENDITURES

FROM JUNE 20, 1960 TO DECEMBER 31, 1961

(Note 6)

	June 20, 1960 to December 31, 1960	Year Ended December 31, 1961	June 20, 1960 to December 31, 1961
General Exploration Expenditures			
Lease rentals and leasing expenses	$ 110.00	$ 15,498.50	$ 15,608.50
Engineers' fees and expenses	1,889.37	2,127.70	4,017.07
Geophysical data (acquired for 10,000 shares of capital stock)	—	4,000.00	4,000.00
Depletion of leasehold and intangible well costs	—	4,040.05	4,040.05
Depreciation of well equipment	—	4,694.39	4,694.39
	$ 1,999.37	$ 30,360.64	$ 32,360.01
Administrative and General Expenditures			
Consideration paid for the surrender of certain rights by participants in joint-venture (Note 10)	$ —	$105,000.00	$105,000.00
Interest bonus on loan	10,000.00	—	10,000.00
Legal fees and disbursements	9,400.00	14,614.90	24,014.90
Head office services, including accounting and secretarial fees	1,994.36	3,375.97	5,370.33
Shareholders' information and publicity	2,106.38	6,838.84	8,945.22
Interest expense	—	4,452.68	4,452.68
Canadian Stock Exchange—fees and expenses	—	1,505.64	1,505.64
Transfer agent's fees and expenses	1,810.02	920.75	2,730.77
Manager's salary	1,000.00	3,000.00	4,000.00
Directors' fees	—	900.00	900.00
Audit fees	860.00	1,350.00	2,210.00
Travelling expenses	554.11	699.20	1,253.31
Government fees	—	642.65	642.65
Cost of supplementary letters patent	1,000.00	—	1,000.00
Miscellaneous expenses	2,608.35	(276.60)	2,331.75
	$ 31,333.22	$143,024.03	$174,357.25
Total Exploration, Administrative and General Expenditures Before the Undernoted Deductions	$ 33,332.59	$173,384.67	$206,717.26
Deduct—company's share of net proceeds from producing wells	—	38,517.90	38,517.90
Total Deferred Expenditures	$ 33,332.59	$134,866.77	$168,199.36

The accompanying notes are an integral part of the financial statements.

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